DEVELOPMENTS OF FDI FOR SLOVAKIA AND HUNGARY

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Abstract

International buying and selling plays a key role in the development of the world economy and countries. There are several ways to boost a country's economy, such as by the inflow of capital from abroad. In addition to increasing efficiency and competitiveness, it brings knowledge, competences and technologies that have not been present in the host country earlier, and they can add novel elements to the local economy, allowing them to move upwards in their development trajectory. At the time of privatization, foreign investment was a key type of capital investment, as it played a role in issues referring to the structure of the market and in the development of a market economy. As in many other economies, in the Slovak and Hungarian economies that were undergoing regime change, foreign investment has been significantly contributing to effective economic change. Through foreign capital investment, both countries have embarked on the path of economic development and continued to reap the benefits of incoming capital sources to this day. The aim of this study is to learn about the theoretical background of the impact of FDI on countries. In addition, the paper aims to compare the international perception of the economic situation of Slovakia and Hungary and to examine how FDI inflow has changed in the recent period in both countries. Our research is based on secondary data obtained from the UnctadSTAT database and from the Fraser Institute comparison, plotting and analysing the obtained data through graphs. The analysis of data from a ten-year interval revealed some surprising findings in the case of both countries, but the complexity of the studied area leaves room for further questions to be answered.

Keywords: *foreign direct investment, macroeconomics, Slovakia, Hungary*

JEL Classification: E22, F16, F62

Introduction and theoretical background

Globalisation can be seen as a driver of trade, export and import activity between countries. In the spirit of competitiveness, a sales relationship is established between countries, which brings along the improvement of the economic situation

and the appearance of foreign investors and international companies on domestic markets. The target countries can benefit from a number of advantages through foreign investment. These are primarily capital and new investment flowing into the host country, reforming of the corporate and institutional environment, playing a role in the development of macroeconomic indicators and the development of an effective economic system. Over the past few decades, central and eastern European countries, including Slovakia and Hungary, have undergone similar processes due to their similar historical and cultural backgrounds. These countries are not only close to each other in geographical terms, but also have the same economic structure and similar infrastructure. For this reason, they are significant competitors in terms of foreign capital investments (Mura & Zsigmond & Machová, 2021). Since the 1990s, a strong wave of foreign investment has started, which has also had an impact on the restructuring of the countries concerned (Kalotay, 2010). After the change of regime, in both countries there was a significant need for foreign investment, which unfolded when they joined the European Union in 2004 and became a significant part of the economy. The geographical location of the countries is an advantage that can be exploited, as the location between East and West hides several opportunities to be exploited from the point of view of buying and selling (Sőreg, 2019). After the change of regime in Central and Eastern Europe, foreign capital flows were considered decisive, which also determined the direction and pace of development in the two countries (Gál & Fazekas, 2021).

In the case of post-communist countries, inflows from abroad have played an important role at both national and regional levels (Sipikal, 2010). Foreign Direct Investment (FDI) involves the relocation of a company's activities and specific processes from home to abroad (Acs et al., 2007). The growth and volume of foreign investment is mainly influenced by the potentially attractive business environment for investors in the host countries (Fifeková & Nemcová, 2015). Foreign capital investment is long-term and has an impact on the economic development and speed of the host country (Fabuš & Csabay, 2018). They enrich the target country with many advantages and involve great duty (Rodionova & Yakubovskyi & Kyfak, 2019). Investors do not change their minds unexpectedly, unlike short-term investments, as well as types of investments that are more resilient to crisis situations (Götz et al., 2018). Attracting foreign direct investment is the main objective of emerging economies (Hampl & Havranek & Irsova, 2020). In addition to investing in material goods, they provide the host countries with various forms of know-how transfers, bringing managerial and marketing specificities and novel production processes to the destination country. An economy can reap the benefits of FDI if it is willing to deepen and use its capacities to absorb foreign capital (Almfraji & Almsafir, 2014; Kostownians, 2016). The evolution of unemployment and employment varies periodically and differently from the type of capital from abroad (Strat & Alexandru & Vass, 2015).

The continuous growth of FDI has allowed the emergence of non-existent industrial sectors. In the countries of Central Europe, the automotive industry is worth mentioning. Slovakia has undergone a radical change due to the influence of the West. Between 2004 and 2008, Slovakia's imports ranged from 67.6% to 73%, and its exports to Europe ranged from 85.2% to 86.8%. Leaving the economic crisis of 2009 behind, foreign capital has been constantly flowing to the country, which has also positively affected the efficiency of work (Rajnoha et al., 2018). Since 2009, the official currency of the country has been the euro, from the introduction of which residents expected positive changes in terms of buying and selling abroad (Šeben et al., 2019). The country's GDP and employment rate have also risen. Slovakia's most important

foreign investor from the west is the Netherlands, Germany and Australasia. In terms of investment, the western part of the country has been the most favorable and most successful, as it has a well-developed infrastructure. The cities of Nitra and Galanta are home to companies with foreign capital (Táncošová, 2019). The beneficial effect of FDI on regional unemployment can be illustrated through a concrete example, when the opening of a Samsung plant in Galanta resulted in a significant decrease in unemployment in the district and in the surrounding regions. The investment of the corporation has had a significant impact on employment, and the same trend applies to neighbouring areas where a large foreign company of similar importance has invested. Foreign capital promotes the development of the Slovak economy and favors certain regions of the country (Dudáš, 2013; Minarčík, 2009).

After the change of regime, Hungary proved to be an FDI-focused country, and since 1991 it received a significant amount of FDI, except for the period between 2015 and2016 (Tőkés, 2019). Hungary was the first country in Central Europe to be open to foreign investment. In 2000, the number of foreign capital investments was higher than in any other Visegrad country. It ceased to be the primary receiver of FDI in the region in the years 2009 and 2010 (Sass, 2004). To this day, the country still has a prominent position in terms of working capital inflows from abroad, which is also recognized in international comparison. FDI success is also the result of the failure of domestic companies. The change of regime also meant the failure of domestic companies, which facilitated the expansion of foreign companies (Sass & Kalotay, 2012). Hungary, like the other Visegrad countries, focused primarily on supply chains and the automotive sectors, primarily to attract FDI in Germany. Initially, foreign investors benefited from privatization, then greenfield investments became increasingly important (Bohle & Regal, 2021). FDI projects in the electronics sector proved attractive, towards which Hungary took the first step, Slovakia joined only later (Antalóczy & Sass, 2001). Hungary's FDI share in GDP is high (67%), which proves both its integration with EU economies and its dependence on international companies abroad. In Slovakia, this FDI share is much lower. Nevertheless, as far as the manufacturing sector is concerned, the shares of foreign subsidiaries in Slovakia (80%) and Hungary (70%) are very high. Hungary's most developed counties are in Central Hungary, Western Transdanubia and Central Transdanubia, and the foreign capital stock per capita is also highest in these regions. The backward regions of the country are in Eastern Hungary and South Transdanubia, where there is a shortage of foreign investment (Gál, 2019).

Government provisions affecting FDI

The regions that attract foreign investors and investment the most are those that provide the lowest investment costs, thereby providing opportunities to make higher profits and reduce risks. Certain regions and countries may offer more benefits to investors, preferring investment opportunities (Dorozynski & Kuna-Marszalek, 2016). The legal and institutional conditions of a country significantly affect foreign investors. Research suggests that a country's tax policy is one of the key factors for investors (Edwards & Newton, 2016). A simple tax system can increase the amount of foreign investment flowing into the country (Van Parys & James, 2010). Based on Kłysik-Uryszek (2011), among the most relevant conditions are:

1. economic, political, and social stability, level of corruption, security, legal and administrative regulations
2. the existence of state aid, investment incentives, discounts for investors
3. market competition, risk of entry, operational requirements
4. the existence and efficiency of institutions supporting investors, the efficiency of state administration, the business environment.

The countries studied, Hungary and Slovakia, have been member states of the European Union since 2004, which significantly facilitated foreign capital inflows into the countries (Tintin, 2013). In addition to various investment incentives, the countries that most effectively attract foreign investors have a stable, predictable political system and business environment. In addition, reliable state institutions are built that support foreign investors (Bobenič Hintošová et al, 2021).

In the case of Hungary, a specialized agency helps foreign investors, the National Investment Agency (HIPA), which is managed by the Ministry of Foreign Affairs and Trade. The Hungarian market is divided into eight sectors: automotive, business service centers, electronics industry, information and communication technology, food industry, life sciences, logistics and transportation, renewable energy and medical technology (Gáspár-Szilágyi, 2019). In terms of legal regulations, Hungary has adopted an independent law that helps screen foreign investments. Under the Hungarian Law LVII of 2018, investors operating in sensitive sectors are obliged to declare their activities to the competent Hungarian minister. Based on the declaration, the relevant minister checks whether the investment affects the security interests of Hungary (LVII of 2018). The country offers the following investment incentive discounts:

- tax benefits,
- cash grants,
- low-interest loans,
- obtaining free or preferential land.

Hungary offers foreign investors an income tax discount for 13 years after the completion of the investment, which can reach 80% of the amount to be paid (Kotlíková & Blaschke, 2020).

In Slovakia, Law No 57/2018 on regional investment aid regulates the support of foreign investors who want to do business in the country. The country offers the following investment incentives, mainly aimed at promoting regional development (Kotlíková & Blaschke, 2020):

- support for the acquisition of tangible and intangible assets,
- income tax benefit,
- contribution to newly created jobs,
- transfer or rental of immovable property at a price lower than its actual value.

There are several types of comparisons for assessing the economy of each country. The Economic Freedom Index is determined each year by the Fraser Institute. The index ranks countries based on 5 areas: The size of the government; Legal system and security of property rights; Sound money; Freedom to Trade Internationally; Regulation. The data required for comparison are obtained from a secondary source, so they support the statement with objective data (fraiserinstitute.org).

Material and methods

The aim of the study, based on secondary research, is to examine the development of foreign capital in the context of two neighbouring countries, Slovakia and Hungary. First, the findings of previous papers on the topic were presented, which establishes the theoretical background of the researched problem area. Then, the concept of foreign working capital and its importance for the economic development of countries was discussed. Based on earlier published papers, this study also presents the gradual development of FDI in both countries. We were primarily looking for an answer to the question of how the international image of the two chosen countries has

developed in the last ten years. To answer this, we used a secondary source, a ranking published by the Fraser Institute. The institute uses secondary data, including analyses published by Ease of Doing Business and Doing Business, to compare the economic environment of each country in five areas. Comparative data are presented in the form of tables, and a descriptive analysis is made. The current FDI situation in the countries studied is illustrated through graphs along with their explanation. The presented findings come from secondary research. The corresponding data were extracted from the database published by Unctad STAT. The period under review is a ten-year interval, which falls between 2011 and 2021. For transparency and easier interpretation, the data are also shown in graphs. The main benefit of the secondary research is a current summary, displayed in the form of figures, which present the development of foreign capital investments in Slovakia and Hungary over the past ten years.

Research Results

The Fraser institute is a Canadian organization that compares the economic freedom of each country every year. The table below illustrates the rankings of Hungary and Slovakia in the period 2011-2020.

Table 1 Evolution of the economic freedom indicator

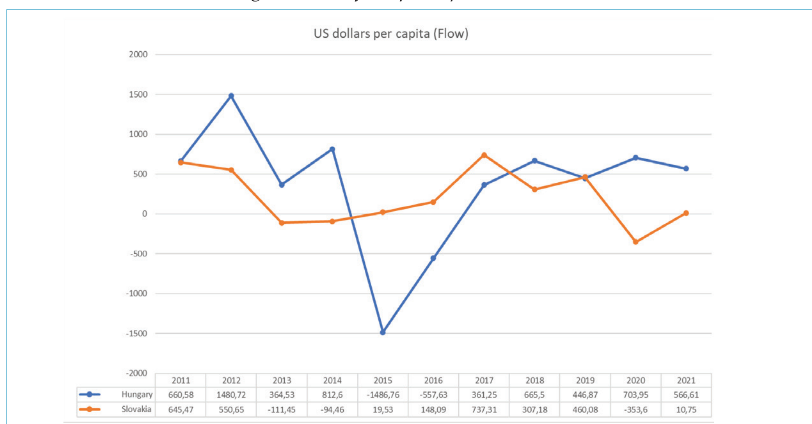
Year		**Country**	
		Hu	**Sk**
2011	Economic Freedom Summary Index	7,61	7,70
	Rank	34	30
2012	Economic Freedom Summary Index	7,58	7,63
	Rank	37	31
2013	Economic Freedom Summary Index	7,51	7,61
	Rank	43	35
2014	Economic Freedom Summary Index	7,60	7,70
	Rank	44	35
2015	Economic Freedom Summary Index	7,48	7,54
	Rank	50	46
2016	Economic Freedom Summary Index	7,61	7,62
	Rank	45	44
2017	Economic Freedom Summary Index	7,55	7,61
	Rank	47	43
2018	Economic Freedom Summary Index	7,49	7,62
	Rank	52	45
2019	Economic Freedom Summary Index	7,51	7,61
	Rank	53	46
2020	Economic Freedom Summary Index	7,24	7,33
	Rank	57	54

Source: fraserinstitute.org

Based on the data in the table, it can also be said that in 2011 both countries were ranked higher by the organization compared to 2020: Hungary slipped 13 places in total in the ranking issued by the Institute, while Slovakia fell back14 places. According to the statement, Slovakia has a more advantageous business environment for investors than Hungary throughout the period under review. In 2013, Hungary was transferred to the 2nd Quartile of countries from the group of countries with the freest economies, and in 2015 Slovakia was also downgraded to the same category. Both countries have achieved the most visible deteriorations in the categories examined by the Institute in the last 10 years in the Sound Money and Regulation categories. Factors in the Sound Money category include the rate of inflation, the amount of money the country holds, and the possibility of owning a foreign currency bank account within the country. The factors in the Regulations category are borrowing provisions, labour market provisions and business start-up provisions.

In the next part of the research, the actual development of foreign investment was analysed. For this purpose, data from secondary sources were used, namely data from UnctadStat. The graph below illustrates how the amount of FDI flow per capita developed in each country in the period 2011-2021, shown in US dollars. The per capita breakdown was necessary because, due to the size differences between the two countries, it would not give an accurate picture just to compare the amount of capital inflow.

Figure 1: FDI flow per capita (US dollars)



Source: own edit based on Unctad STAT data

The comparison of the data shows that Slovakia had a negative or lower FDI flow in the period from 2013 to 2016, with the highest number of foreign investments coming in in2017, followed by another low in 2020. The evolution of FDI per capita is much more diverse in Hungary. In 2012, the country received the largest amount of foreign investment, namely 1,480.72 dollars per person, but in 2015 the country recorded a record negative value, the value of FDI flow was -1,486.76 dollars per person.

Conclusion

The aim of the study was to get an idea of the economic perception of Slovakia and Hungary abroad, and of the development of the volume of foreign investments over the last 10 years. Hungary and Slovakia share a common history, similar economic and political structures and cultural backgrounds. Throughout history, they have been parts of the Austro-Hungarian Monarchy, then belonged to the Soviet Block, and now both are member states of the European Union and of the Visegrad Four. FDI became available to individual countries after the regime change, but in the first few years, during the privatization, FDI did not automatically bring along the creation of new jobs.. However, until the economic downturn of 2008, several greenfield investments had already been established in the region, and Hungary received the most of FDI. Each country can offer different incentives for investors to attract them into their country. In Hungary, a state institution deals with direct assistance for investors, but at the same time it has to report on its activities to individual ministries. Both countries offer tax breaks and cheap loans to investors, mainly to support entrepreneurship in certain regions.

Relying on secondary sources, namely the ranking prepared by the Fraser Institute, the international image of Hungary and Slovakia was evaluated for the period 2011-2020. There were changes in the ranking of both countries, with Slovakia having been downgraded in 2015 and Hungary in 2013 into the category of countries offering a less favourable economic environment.

In addition, based on secondary data, we compared the amount of FDI per capita flowing into the two countries in the period 2011-2021. Based on the data obtained, it can be stated that both countries are popular among foreign investors. In the case of Slovakia, the lowest FDI amount was received in 2020, and the country also reported a negative bottom line in terms of FDI in 2012. There have been significant fluctuations in Hungary as well. , While the highest amount of FDI arrived in the country in 2012, the FDI inflow was recorded in 2015.

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